

Significant amendments proposed for charitable institutions in respect of provisions relating to computation of income



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Finance Act of every year contains legal amendments on direct and indirect taxation to achieve certain socio-economic objectives. One of the prominent arenas of direct taxation in which amendments are made relate to the legal provisions applicable for charitable trusts / institutions. The frequency of the amendments shows, how the previous changes are not made with foresight and thus tinkering of legal provisions in every Finance Act for charitable trusts / institutions has become habitual. The provisions relating to taxation or tax relief for non-profit organisations are rigid across the countries since any leeway for abuse of the tax concession could trigger huge revenue loss to the exchequer. Thus, rigidity in legal provisions for NGOs/NPOs is justified but the frequency of changes to the legal provisions made in India shows inadequate preparatory process in drafting the same by not visualizing various scenarios that may emerge after the legal amendments become operational. The Finance Bill, 2023 is no exception to remedying the previous amendments and thus host of amendments are proposed for NGOs. This article takes a snapshot of the legal amendments proposed in the Finance Bill, 2023 with specific reference to those applicable for computation of income.

1. Measures for moderating the legal provisions relating to corpus fund and borrowings

(a) *Insertion of second proviso to clause (i) of Explanation 2 to the third proviso of section 10(23C):* Explanation 2 to the third proviso of section 10(23C) says that for the purposes of determining the amount of application, any amount spent from corpus shall not be treated as application of income for charitable or religious purposes. The existing first proviso to the Explanation 2 says that when the expended corpus amount is replenished /restored subsequently it shall be treated as application of income. **The second proviso to Explanation 2 to third proviso to section 10(23C) proposed to be inserted says that the benefit of first proviso would be available only when there is no violation of the twelfth, thirteenth and twenty-first proviso and Explanations 2 and 3 of section 10(23C).** It would be apt to take note of the referred to provisos and Explanations.

- ◆ The twelfth proviso to section 10(23C) deals with the amount paid or credited to yet another charitable trusts or institutions towards corpus donation.
- ◆ The thirteenth proviso to section 10(23C) is meant for determining the amount of application of income by the trust or institution after taking note of sections [40\(a\)\(ia\)](#), [40A\(3\)](#) and [40A\(3A\)](#) which shall apply mutatis mutandis as they apply in computing the income chargeable under the head 'Profits and gains of business or profession'.
- ◆ The twenty-first proviso to section 10(23C) is meant to deny the benefit of tax exemption where the income or part of the income or property of any fund etc., is for the benefit of any person referred to in section [13\(3\)](#).

- ◆ Explanation 2 to section 10(23C) is meant for calculation of income or accumulation of income as the case may be, without any set off or deduction or allowance of any excess application of any of the year preceding to the previous year.
- ◆ Explanation 3 to section 10(23C) is meant to consider any sum which is actually paid shall be considered as application of income, which means the NGOs application of income would be reckoned on cash basis irrespective of the method of accounting regularly employed by it.

Thus, the second proviso of clause (i) of Explanation 2 to the third proviso of section 10(23C) is meant to control or regulate the benefit of treating the replenishment / restoration of corpus amount subject to the condition that the initial utilization was not in violation of twelfth, thirteenth and twenty-first proviso besides Explanation 2 and Explanation 3 of section 10(23C).

The Finance Bill, 2023 proposes to insert second proviso to clause (i) of Explanation 4 to section [11\(1\)](#) which is similar to the above said amendment but applicable for charitable trusts and institutions for whom income is computed under section 11.

- (b) *Insertion of third proviso to clause (i) of Explanation 2 to the third proviso of section 10(23C):* The Finance Bill, 2023 says that the corpus amount which was used for pursuing the objects of the trust when replenished or deposited back in one or more of the forms or modes specified in section 11(5) it would be treated as application **only if such investment or deposit is made within a period of 5 years from the end of the previous year in which such application was made earlier from the said corpus.** Thus, if an NGO has spent Rs.10 lakhs out of corpus fund in financial year 2023-24, it has to be deposited back before 31.03.2029 so that it would be treated as application as and when such deposit /restoration is made to the corpus. Where the corpus fund is deposited /restored after 31.03.2029 it would not qualify for being treated as application of income of the trust or institution while computing its income.

The Finance Bill, 2023 proposes to insert a third proviso to clause (i) of Explanation 4 to section 11(1) which is similar to the above said amendment but applicable for charitable trusts and institutions for whom income is computed under section 11.

- (c) *Insertion of fourth proviso to clause (i) of Explanation 2 to the third proviso of section 10(23C):* The Finance Bill, 2023 proposes to insert fourth proviso to clause (i) of Explanation 2 to third proviso of section 10(23C) so as to provide that the **benefit of the first proviso will not apply where the application out of corpus is made on or before 31st day of March, 2021.** In other words, where an NGO has applied the corpus fund for pursuing the objects of the trust (whether revenue or capital expenditure) up to 31st March, 2021 any replenishing / restoring the corpus fund subsequently, will not be treated as application of income. Obviously, because when the expenditures were made from the corpus up to 31st March, 2021 it would have been treated as application of income by the trust or institution and therefore its replenishment / restoration to the corpus after 31st March, 2021 would not be considered as application as that would amount to double benefit being accorded to the trust or institution.

The Finance Bill, 2023 proposes to insert fourth proviso to clause (i) of Explanation 4 to section 11(1) which is similar to the above said amendment but applicable for charitable trusts and institutions for whom income is computed under section 11(1).

- (d) *Insertion of second proviso to clause (ii) of Explanation 2 to third proviso of section 10(23C):* Clause (i) of Explanation 2 to third proviso of section 10(23C) deals with usage of corpus amount by trust or institution and its eligibility for application subsequently when the amount is invested or deposited back, into one or more forms or modes specified in section 11(5). Clause (ii) of Explanation 2 to third proviso of section 10(23C) deals with application made by charitable trust or institution from any loan or borrowing. Such application out of loan or borrowing shall not be treated as application of income for charitable or religious purposes. The first proviso to clause (ii) of Explanation to third proviso of section 10(23C) however states that when the loan or borrowing is repaid from the income of the trust subsequently, it shall be treated as application of income of that year. **The Finance Bill, 2023 proposes to insert second proviso to clause (ii) of Explanation 2 to the third proviso of section 10(23C) to act as a caveat that the first proviso will apply only if there is no violation of the conditions specified in twelfth, thirteenth and twenty-first proviso besides Explanation 2 and Explanation 3 of section 10(23C). The coverage of twelfth, thirteenth and twenty-first proviso besides Explanations 2 and 3 of section 10(23C) have already been discussed in (a) above.**

The Finance Bill, 2023 proposes to insert second proviso to clause (ii) of Explanation 4 to section 11(1) which is similar to the above said amendment but applicable for charitable trusts and institutions for whom income is computed under section 11(1).

- (e) *Insertion of third proviso to clause (ii) of Explanation 2 to the third proviso of section 10(23C):* **The Finance Bill, 2023 proposes that the amount of loan or borrowing shall not be treated as application for charitable or religious purposes unless the repayment of loan or borrowing is made within a period of 5 years from the end of the previous year in which such application was made from the said loan or borrowing.** Similar to the third proviso to clause (i) of Explanation 2 to the third proviso of section 10(23C), the repayment of loan or borrowing within 5 years would only be treated as application of income. This legal amendment seems to be myopic and unjustified. The intent of the amendment is that if a trust or institution who has borrowed a loan in financial year 2023-24, it has to repay the loan or borrowal before 31.03.2029, to claim the same as application. Any repayment of loan / borrowing after 5 years from the end of the previous year in which the application was made, would not be treated as application of income.

The Finance Bill, 2023 proposes to insert a third proviso to clause (ii) of Explanation 4 to section 11(1) which is similar to the above said amendment but applicable for charitable trusts and institutions for whom income is computed under section 11(1).

- (f) *Insertion of fourth proviso to clause (ii) of Explanation 2 to the third proviso of section 10(23C):* **Any loan or borrowing which is repaid shall not be treated as application where such loan or borrowing is made before 31st March, 2021.** Obviously, the intent of the insertion of the fourth proviso proposed in the Finance Bill, 2023 is to deny the benefit of repayment of loan as application since such loan utilization would have been treated as application up to the previous year ending 31.03.2021. Absence of fourth proviso would go to provide double deduction viz. one at the time of borrowing matched by utilization and again upon repayment in the subsequent period. This amendment seems to be logical and proper.

The Finance Bill, 2023 proposes to insert a fourth proviso to clause (ii) of Explanation 4 to section 11(1) which is similar to the above said amendment but applicable for charitable trusts and institutions for whom income is computed under section 11(1).

2. Inter-trust donations

The Finance Bill, 2023 proposes to regulate inter-trust donations with an observation that certain trusts or institutions try to defeat the intention of the legislature by forming multiple trusts and accumulate 15% at each layer by means of inter-trust donations. Thus, the Finance Bill, 2023 proposes to insert clause (iii) in Explanation 2 to the third proviso of section 10(23C) to provide that any amount paid or credited out of the income of the trust or institution to any other trust or institution (being eligible entity) shall be treated as

application only to the extent of 85% of such amount credited or paid. It also takes note of the twelfth proviso and thus any inter-trust donation out of accumulated amounts shall not be treated as application of income.

Correspondingly, the Finance Bill, 2023 proposes to insert clause (iii) in Explanation 4 to section 11(1) in order to apply the similar condition / restriction applicable for trust or institution registered under section 12AB of the Act making inter-trust donation (out of its income and not out of accumulated income) eligible for only 85% as application of income.

3. Consequence of not filing application for registration:

All charitable trusts and institutions covered by section 10(23C) (except (i) to (iiiie)) and section 11 were required to apply for re-registration or approval before 31.03.2021. The due date for re-registration or approval was extended up to 25.11.2022 vide CBDT Circular No.22 of 2022 dated 01.11.2022. The re-registration /approval in the case of existing trusts / institutions is valid for 5 years. The new trusts and institutions also have to apply for registration one month before the commencement of the previous year relevant to the assessment year from which the registration is sought. Those institutions were granted provisional registration / approval for a period of 3 years.

The rationale behind the amendment proposed by the Finance Bill, 2023 was that certain trusts and institutions have not applied for regular registration after taking provisional registration. Similarly, certain existing trusts / institutions have not applied for re-registration / approval. Once a trust or institution has availed exemption from tax it can exit only on payment of tax at the maximum marginal rate on its accreted income. The accreted income represents the income on which tax has not been paid previously and tax relief was obtained. By not applying for re-registration / approval the trust and institution may get an easy route to exit without payment of tax on the accreted income.

The Finance Bill, 2023 proposes to insert clause (iii) in section [115TD\(3\)](#) to provide that the provisions of Chapter XII-EB shall be applicable if any trust or institution fails to make application in accordance with the provisions of the Act for registration or re-registration within a period specified in the respective provisions. The trust or institution shall be deemed to have been converted into any form which is not eligible for registration under section [12AA](#) or section [12AB](#) or applicable sub-clause of section 10(23C) in the previous year in which the time period for application expires. Thus, Finance Bill, 2023 effectively closes any scope for charitable trusts or institutions to gain relief from exit tax by not seeking re-registration / approval etc.

Conclusion

The amendments proposed in the Finance Bill, 2023 effectively shuts down any opportunity for avoiding tax by exiting from the provisions applicable for charitable trusts and institutions. Similarly, any leverage provided for inter-trust donations is effectively closed with the amendment proposed in the Finance Bill, 2023. One of the unjustified amendments proposed in the Finance Bill, 2023 relates to repayment of borrowing or loan with a time restriction of 5 years in order to be eligible as application of income. This time restriction does not seem to be proper and also as regards restoration of corpus within time period of 5 years seems to be unjustified since the flow of income of the trust or institution may not be certain and when the utilization of corpus or borrowing when not treated as application, there is no reason to provide a time limit for restoration of corpus or repayment of loan for considering the same as application of income. These amendments may be revisited by the lawmakers to rhyme well with the practical realities.

